Investigation by the Department of Public Utilities on its own Motion into Rate Structures that will Promote Efficient Deployment of Demand Resources

D.P.U. 07-50

Comments of The Berkshire Gas Company

September 10, 2007

Executive Summary

The Berkshire Gas Company ("Berkshire" or the "Company") appreciates the opportunity to respond to the straw proposal and various questions posed by the Department of Public Utilities ("D.P.U." or the "Department") regarding rate matters affecting the efficient deployment of demand resources as raised in the Department's order in docket D.P.U. 07-50 issued on June 22, 2007. Berkshire has been a strong proponent of energy efficiency programs since its first program offered pursuant to D.P.U. 91-154. In fact, Berkshire was one of the first local distribution companies ("LDCs") to implement comprehensive energy efficiency programs in the Commonwealth. From 1993 to 2006 Berkshire helped its customers save nearly three million therms. Berkshire submits that, given current conditions in the energy market, it is appropriate to revisit ratemaking principles to ensure fairness and consistency with important policy objectives such as the promotion of demand resources. For example, current rate structures may not necessarily align utility incentives with respect to demand response but also do not reflect the reduction in usage per customer that, has in turn, affected the Company's ability to generate the allowed revenues to recover its costs in rates. Thus, Berkshire is pleased that the Department has presented a straw proposal for a base revenue adjustment mechanism which could align incentives and, at the same time, might alleviate the impact that declining use per customer has had on the Company's ability to recover its costs.

As a general matter, Berkshire submits that performance-based ratemaking is not inconsistent with the proposed base revenue adjustment mechanism. Indeed, the Company believes that

rate decoupling and performance-based ratemaking are best pursued on a complementary basis. Berkshire also believes that the Department's decoupling initiative may be efficiently implemented as it does not require a full cost of service review; the Company's just and reasonable rates may be employed as a starting point (subject to annual adjustments pursuant to the price-cap mechanism) and then a new analysis performed at the expiration of the Company's rate plan in 2012. The Company notes that performance-based rate plans are an important element in managing costs while the straw proposal may be a complementary means to reconcile revenues.

Berkshire does not believe that there is evidence of a need for any cost of service adjustments, including to its allowed rate of return on equity. Requests for added risk premia have been rejected by the Department in the past in setting allowed returns. A new regulatory regime such as that under consideration raises uncertainty and does not address all risk changes experienced by the Company. Moreover, the straw proposal is symmetrical in that it affects both risk and opportunity. A new rate of return should be established for Berkshire in 2012 on a comprehensive basis (considering all risk factors) at the time all cost of service issues will be reviewed.

Berkshire believes that the Commonwealth will be best served by the adoption of general ratemaking principles that are then implemented on a case-by-case basis that reflects the particular circumstances of each company. For example, Berkshire notes that most gas utilities in New England are experiencing a dramatic decrease in use per customer but understands that electric utilities are experiencing different market conditions. In addition, Berkshire's service area is experiencing very different economic conditions than more urban service areas.

Finally, the Company submits that the straw proposal, with several additional modifications described herein, may be implemented in a manner that advances the stated policy goals while advancing the Department's established ratemaking principles (certainty, efficiency, strong incentives) for the benefit of customers and the Company. The Company's comments are based upon issues of more general application. The Company hopes that there is another opportunity to comment upon the details of implementation for any decoupling initiative.¹

Berkshire will also address the questions posed in the June 22 Order.

Response to Questions

1. The Department's proposal that a company's allowed revenues per customer be determined through a subsequent rate proceeding is intended to ensure that the allowed revenue levels, which serve as the basis for the base revenue adjustment mechanism, are closely aligned with the company's costs. Under what, if any, circumstances should the Department permit a company's allowed revenues per customer to be determined through some manner other than a base rate proceeding?

Berkshire submits that a company's allowed revenues per customer should be determined on a company-by-company basis. For instance, several operating companies in Massachusetts, including Berkshire, are in the midst of a long-term rate plan. It would be inefficient and costly to ratepayers to end a rate plan early and to incur the cost of a subsequent rate proceeding. Berkshire's rates pursuant to its own plan were, in fact, recently determined to be "just and reasonable". The Berkshire Gas Company, D.T.E. 07-32 (2007).

¹ Decoupling initiatives should preserve the flexibility that exists in most performance-based rate plans to implement

more flexible arrangements for larger commercial and industrial customers.

In the case of Berkshire, specifically, the Company has been in a long-term rate plan since 2002. Each year since the plan began, the Company has filed annual compliance filings with the Department that have been reviewed and approved. In fact, the fourth annual rate adjustment filing was approved in docket D.P.U. 07-38 on August 20, 2007. In that Order, the Department concluded on page 2 that "... the Company's calculations of the adjustment of net income for earnings sharing, PBR adjustment, inflation factor and normalized revenues are in compliance with the requirements of its PBR plan approved in D.T.E. 01-56." Further, the Department recently approved Berkshire's mid-period proposal to complete its rate plan pursuant to docket D.P.U. 07-32. The Department held that "the Company's rates under its PBR plan, for the purposes of the mid-period report, remain just and reasonable. Therefore, the Department direct[ed] the Company to continue the PBR plan without modification, with successive annual adjustments through 2012."²

In the instance of both the annual rate adjustments and the mid-period review, it is also apparent that the Company's long-term rate plan has been an effective tool in providing continuing just and reasonable rates to its customers. To abandon the plan and require Berkshire to file a new base rate proceeding in order to decouple rates is both inefficient and costly to ratepayers and also eliminates incentives that had been in place to maintain costs. Berkshire would propose that its rates could be effectively decoupled, on a revenue-neutral basis, using its most recent compliance filing approved in docket D.P.U. 07-38 on August 20, 2007 (or any subsequent adjustment if decoupling is initiated later). These rates, which have an established "revenue target," will be used as the basis to determine the initial allowed revenues per customer. Because the

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² The Department noted that since the inception of the rate plan, Berkshire's distribution rates increased by 3.99% on a compounded basis while the Company experienced inflation at nearly 13%.

Department has already completed its necessary evaluation and has determined Berkshire's rate plan should be continued for the remaining five years (with the price cap mechanism formula being applied to adjust the allowed revenue per customer), applying these established costs would be the most cost-effective and efficient means for Berkshire to decouple its rates. In sum, the Department should be flexible in how it implements any rate decoupling structure.

2. The Department's proposal uses an approach in which a company's allowed revenues per customer for each rate class does not change between base rate proceedings. An alternate approach would be to adjust the allowed revenues per customer values periodically, based on changes in each rate class' average usage per customer. Please discuss the merits of each approach.

The Company does not agree that a company's allowed revenues per customer for each rate class should not change between rate proceedings. If this were to occur, it could eliminate one of the incentives for a utility to encourage further conservation on its system and will likely result in fewer long-term efficiency initiatives than have been implemented pursuant to performance-based rate plans and more frequent base rate proceedings in light of (i) continuing inflationary pressure, (ii) the need to make new non-revenue producing investments, (iii) continuing reductions in usage per customer and (iv) similar factors. Berkshire's position is that the allowed revenues should be calculated at least annually in order to establish accurate price signals for customers. Given its long-term rate plan, it would not be in the best interests of customers or the Company in terms of rate continuity to delay the necessary pricing adjustments for an extended period. If the new rate structure encourages conservation as it was intended

to do, then the annual adjustment would be a necessary component of an equitable plan.

3. The Department's proposal that a company's actual versus allowed revenues be reconciled annually is intended to balance three objectives: rate stability, rate continuity, and administrative efficiency. Do annual reconciliations strike an appropriate balance among these three objectives or would alternate reconciliation periods (e.g., quarterly or semi-annually) better do so?

In order to respond appropriately to this question, it is important to understand the various rate design mechanisms that could be in place. First, if a company were to implement a straight fixed charge rate design – that is, there is no volumetric charge – then annual reconciliations would suffice since there should not be significant changes in a particular year in how a company is operating. Alternatively, if a company has a combination of a fixed charge rate design as well as volumetric charges, then more frequent reconciliations would be necessary to avoid large adjustments and in order to send the appropriate price signal to customers. The Company would propose that with this type of rate design, adjustments should be made semi-annually at the same time the cost of gas adjustment and local distribution adjustment are adjusted. Quarterly reconciliations would be likely inefficient and cause more customer confusion due to proration and more frequent rate changes and are, therefore, not recommended.

4. The Department's proposal to determine a company's actual revenue based on billed revenues is consistent with the base rate treatment applied to distribution-related bad debt costs. An alternate approach would be to determine actual revenues based on payments received. Please discuss the merits of each approach.

The Department's proposal to determine actual revenue based on billed revenues is a sound approach, consistent with other adjustment mechanisms (i.e., the cost of gas adjustment) and should be implemented. Revenues are recorded when gas is delivered. This is a consistent approach with generally accepted accounting principles, best matches all other external reporting requirements, and accurately reflects revenues. Payments received are not a true measure of revenues due to issues such as the lag time between billing and payment and budget billings. Also, there would be a disincentive to invest in bad debt collection activities with this approach as uncollected revenues would be allocated to the remaining ratepayers.

- 5. The Department's proposal for determining billed revenues is based on actual consumption. An alternate approach would be to determine billed revenues based on consumption normalized for weather and/or other factors.
 - (a) Please discuss the merits of determining billed revenues using actual versus weather-normalized consumption.

Billed revenues reflect the most accurate method of determining the appropriate revenues. Actual revenues are readily determined and can be accurately justified. The basis of decoupling is to allow companies to annually recover their revenue target. The application of actual billed revenues best achieves this goal.

(b) Should consumption be normalized for other factors (e.g., economic conditions)?
If so, identify those factors and describe how the normalization for such factors could be done.

As stated above, the determination of allowed revenues based upon actual billed revenues is the most equitable and efficient method to achieve the ultimate goal of decoupling, which is to encourage energy conservation while allowing the utility to recover its revenue requirement. It would be difficult to separate and accurately measure all of the factors that can cause reduced usage such as weather, the economy, customer mix and conservation measures, among other things. Further, if the Company continues to operate under its existing rate plan, as it is proposing and has recently been confirmed by the Department, economic conditions would be factored into the Company's rates pursuant to the annual inflation adjustment. For these reasons, the Company would not propose normalizing for other factors.

6. The Department's proposal to recover the difference between a company's target and projected revenues through adjustments to its base energy charges is intended to send appropriate price signals to consumers. An alternate approach would be to adjust both base energy and demand charges (where applicable) to recover this difference. Please discuss the merits of each approach.

The Company would not propose adjusting the base energy and/or demand charges for the difference between a company's target and projected revenues. Making adjustments to what are essentially the Company's base rates could be confusing to customers, especially if it were to occur more frequently than annually (i.e., at the time the Company's annual price adjustment is effective). Rather, the Company proposes that the application of a separate adjustment mechanism to recover the difference between projected and actual revenues is more logical and administratively feasible.

- 7. The Department's proposal to require a company to submit quarterly filings identifying actual and allowed revenues is intended to ensure that changes in rates are made in a predictable and gradual manner.
 - (a) Under what circumstances should the Department allow an adjustment in base charges during a reconciliation period?

Quarterly filings should only be provided for informational purposes if helpful. As stated in the response to Question 3, reconciliations should only occur on an annual or semi-annual basis. Further, it is the Company's contention, that the only adjustments to base charges (that should be made during a reconciliation period) should be implemented in the context of the annual rate adjustments pursuant to the Company's long-term rate plan.

(b) Under what circumstances should the Department initiate a review of a company's base revenue adjustment mechanism?

The base revenue adjustment mechanism should not require further review if the reconciliations demonstrate that the plan is effective and equitable. However, if an earnings sharing mechanism is in place, as described in the Department's straw proposal, the mechanism may have to be reviewed based on the level of earnings, the bandwidth within the earnings sharing mechanism, and other similar issues. Moreover, earnings sharing provisions should be applied in a manner that is consistent with established rate plans and, because Berkshire's

existing rate plan does not include this feature, earnings sharing features should not be considered for Berkshire until its next rate plan.

8. What standards should the Department use to measure the performance of a company's base revenue adjustment mechanism over time?

In traditional ratemaking, the Department has determined that utility rate structures must be efficient, simple, and ensure continuity of rates, fairness between rate classes, and corporate earnings stability. These same principles can be applied to the Company's base revenue adjustment mechanism. The Department also stated in this proceeding that three objectives should be balanced: rate stability, rate continuity, and administrative efficiency. Thus, the standards to consider could include:

- A. <u>Consistency</u> the mechanism should produce results that meet the
 Departments goals on a consistent basis.
- B. <u>Equitability</u> Price changes should be equitable among all customer classes.
- C. <u>Accuracy</u> the mechanism should accurately reflect all components of the plan to assure correct rate changes and reporting.
- D. <u>Earnings Opportunities</u> the Company should have an opportunity to earn its allowed revenue targets.

- E. <u>Conservation</u> efforts to enhance or promote conservation should be facilitated.
- 9. How will the implementation of a base revenue adjustment mechanism affect a company's risk and how should such considerations be reflected in a company's capital structure and ROE?

The Company is not aware of any specific evidence that suggests a specific adjustment to a utility's allowed rate of return on equity would be appropriate were the Department's decoupling proposal to be implemented. Positive and negative risk factors are continually changing. The Company notes that in prior base rate proceedings, the Department rejected proposals that the allowed rate of return reflect certain industry risk factors. The Company believes that each utility's allowed rate of return should be established after a full, comprehensive review at the time of its next base rate review, in Berkshire's case, at the expiration of its rate plan in 2012. Moreover, as the Company believes that its existing performance-based rate plan should remain in effect, partial changes to only a single aspect of this well-balanced plan are not appropriate.

10. The Department's proposal to include a shared earnings provision in the base revenue adjustment mechanism is intended to strike an appropriate balance between the risks borne by customers and shareholders associated with company earnings. Please comment on the merits of such a provision. Also, comment on the design of the proposed earnings sharing provision.

Berkshire's existing long-term rate plan does not include an earnings sharing provision and, thus, the Company does not propose to alter its existing comprehensive and well-balanced plan.

11. Please comment on the merits of implementing a base rate adjustment mechanism with and without the individual elements of a PBR plan (<u>e.g.</u>, fixed term, inflation, productivity, performance standards, exogenous factors).

Berkshire proposes that decoupling is another component of rate design and should have no impact on the Company's individual elements of its PBR plan that addresses cost of service in the established price cap formula. The Company proposes to continue its plan in its current form subject to appropriate adjustments to be addressed in this proceeding. As stated in the response to Question 1, the Department found in D.P.U. 07-38 "that the Company's rates under its PBR plan, for the purposes of the mid-period report, remain just and reasonable." It would be inefficient, inappropriate and contrary to customer and stakeholder interests to discontinue or abandon the plan. Further, to remove only certain components of the plan would change the context of the plan. The plan should be considered in its entirety, not on individual components. Finally, the ability to maintain reconciling charges outside of the plan should continue (i.e. RAMP, PBOP, bad debts, lost margins, ERC).

12. Please comment on how the Department should schedule the implementation of a base revenue adjustment mechanism for each gas and electric company in light of the need to move expeditiously, the resources required to implement such changes, and the specific circumstances of each company. How should the Department determine the order of individual base rate proceedings?

Berkshire would propose that it implement any decoupling initiative employing its just and reasonable rates as a starting basis. This should require limited review by the Department and could be completed in a fairly expeditious manner. Other companies rates would be set on a case-by-case basis, but Berkshire expects that many companies rates could be set efficiently. If a company does not have a long-term rate plan, the order of the proceedings could be based on, among other things, the length of time since a plan was last filed or the size of the company.

13. How should the implementation of a base revenue adjustment mechanism affect the performance-based shareholder incentives that gas and electric companies currently are eligible to receive for promoting energy efficiency?

Currently, Berkshire has the ability to earn some incentives for achievements in its energy efficiency programs. The Company would propose that if significant expansion to increase programs were to occur, Berkshire should have the ability to earn increased or additional incentives.

Conclusion

Berkshire appreciates the opportunity to comment on the rate design proposal put forth by the Department. Berkshire believes that a well-designed decoupling plan that complements its established and recently ratified performance-based rate plan will advance consumer and administrative interests. Berkshire believes that its existing rate plan should be employed to address costs issues and that such a comprehensive plan should not be subject to ad hoc, partial adjustments. Berkshire looks forward to working with the Department and other

interested parties to consider further decoupling initiatives and, hopefully, comment further upon
the details of implementation.